EMPLOYEE BULLETIN

No

4 April 1973

VOLUNTARY INVESTMENT PLAN

1. The Terms and Conditions of the Voluntary Investment Plan have been amended by the Board of Trustees. The amendments, to be effective 3 May 1973, are as follows:

a. The qualifying period for eligibility for membership in VIP has been reduced from three years to one year (Article 2).

b. The Board of Trustees is no longer required to limit its investments to Fidelity Capital and Everest Funds and to U.S. Government securities (Article 3-1). The immediate purpose of this amendment is to authorize an investment contract with a large insurance company offering a high income guarantee with safety of principal.

c. Various sections of the Terms and Conditions have been amended for greater efficiency in VIP's administration and for clarity and conformity of language.

2. Copies of the full text of the amendments are available for examination in the Retirement Affairs Division, 212 Magazine Building and at the Library Reference Desks in Headquarters Building, 906 Chamber of Commerce Building, 825 Ames Building, and 4N-700

DISTRIBUTION: ALL EMPLOYEES

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Tax Information on U.S. Civil Service Retirement and Disability Retirement

Department of the Treasury

Internal Revenue Service

U.S. Civil Service Retirement

While you worked for the Federal government, contributions to the Civil Service retirement fund were withheld from your pay. These contributions were included in your gross income for Federal income tax purposes in the year withheld, and, if not withdrawn prior to retirement, represent your cost of your Civil Service annuity. Also, if you repaid to the retirement fund amounts that you previously had withdrawn, or paid into the fund to receive full credit for certain uncovered service, the entire amount you paid, including interest, is a part of your cost. You may not claim an interest deduction for any payment or repayment designated as interest since this is a part of your cost.

The Civil Service Annuity Statement you received when your annuity was approved shows your "total contributions" to the retirement fund (your cost) and the "monthly rate" of your annuity benefit. The "monthly rate" is the rate before adjustment for health benefits coverage, and life insurance, if any.

The 3-Year Rule

If you will recover the full amount of your cost within three years, beginning on the date on which an amount is first received as an annuity, you may exclude from your income all payments you receive until you recover your cost. Thereafter, your annuity payments will be taxable as ordinary income. Almost all Civil Service retirees use the 3-Year Rule since they normally receive annuity benefits sufficient to recover their cost well within 3 years after they retire.

To determine whether you will recover your cost within 3 years, multiply your initial "monthly rate by 36 (number of months in 3 years). If the result equals or exceeds your "total contributions," you must use the 3-Year Rule.

General Rule. If you will not recover your cost within the 3-year period, you must report your annuity under the General Rule. For information on this rule, see Publication 575, "Tax Information on Pensions and Annuities." This free publication is available by sending a postcard to your Internal Revenue office.

An increase in the monthly rate of your annuity resulting from cost-of-living increases does not affect the method of reporting your annuity on your Federal income tax return. If, at the time you receive your first payment, you determine that you cannot use the 3-Year Rule, you must use the General Rule regardless of an increase in the monthly rate. All such increases are fully taxable. If you determine that you must use the 3-Year-Rule, your entire annuity, including the increase, is excluded from your income until you recover your cost. Thereafter, your entire annuity, including the increase, is fully taxable.

Example. You retired from Federal service on April 15, 1971, and received your first retirement check on June 1, 1971. The Civil Service Annuity Statement shows that the regular "monthly rate" of your annuity is $340, and that your "total contributions" (your cost) are $6,800. To determine whether you will recover the $6,800 within 3 years, multiply $340 (your monthly rate) by 36 (number of months in 3 years). Since $12,240 ($340 x 36) exceeds $6,800 (your cost), you must use the 3-Year Rule.

Your first retirement check was for $510 (the $340 monthly rate for half of April and all of May). You received two more checks at $340 each. Also, you received four checks at $359 each during the balance of 1971, reflecting a cost-of-living increase of $19. Your total annuity received in 1971 of $2,626, therefore, was excluded from your income because you had not recovered your cost of $6,800.

W-2P, "Statement for Recipients of Annuities, Pensions or Retirement Pay," from the Civil Service Commission. It shows the "gross amount" of annuity paid during 1972, the amount you use in computing the taxable portion of your 1972 annuity, as $4,404 (six checks of $359 and six more checks for $375 including a $16 cost-of-living increase).

Since the remaining cost ($4,174) of your annuity was recovered in 1972, part of your 1972 benefits became taxable. On your 1972 Federal income tax return, (Schedule E, Form 1040) $230 should be reported as the taxable portion of your annuity.

After you have recovered your cost of the annuity, all amounts you receive are fully taxable. In the example above, all amounts you receive in 1973 and later years are fully taxable.

Illustrated another way:

1) Amount received in 1971	$2,626
2) Amount received in 1972	4,404
	$7,030
3) Less: Cost	6,800
4) Amount taxable in 1972	$ 230

You can compute the taxable portion of your annuity by substituting the amounts that apply to your situation for the amounts shown above. Also, change the years above, as necessary.

If you filed your application for retirement late or are entitled to accrued payments because your application was processed late, you may receive a lump-sum payment representing the unpaid accrued monthly installments for the period before your regular monthly payments began.

If the lump sum is less than your cost of the annuity, you determine whether the 3-Year Rule applies. Disregarding the lump sum, multiply the "monthly rate" of your annuity by 36; if that cost, you must use the 3-Year Rule. In determining your tax for the year under the 3-Year Rule, the lump sum is treated as a recovery of part of your cost.

If the lump sum exceeds your cost of the annuity, the excess is fully taxable. Also, all the regular monthly annuity payments you receive thereafter are fully taxable.

Return form. Your Civil Service annuity income must be reported in Part I of Schedule E (Form 1040). However, if you fully recovered your entire cost before January 1, 1972, report the total amount received in 1972 on line 40 Form 1040, instead of Schedule E.

Payment of Tax

You may elect to have tax withheld on the taxable portion of your annuity. The Civil Service Commission will furnish you information on how to make the election. A minimum of $5 may be withheld, with additional amounts in even dollars. However, the annuity payment may not be reduced to less than $10. Form W-4P may be used by annuitants to request the withholding.

Form W-2P, "Statement for Recipients of Annuities, Pensions or Retirement Pay," is mailed to you by the Civil Service Commission showing the taxable portion of the annuity as well as the tax withheld if you have made that election. Copy B should be attached to your tax return, Form 1040.

You are not required to have tax withheld. You may instead file a declaration of estimated tax and pay your income tax during the year in which you receive payments. Publication 505, "Tax Withholding and Declaration of Estimated Tax," may be obtained free by sending a postcard to your Internal Revenue office.

Retirement income credit. In addition to personal exemptions and deductions applicable to taxpayers generally, you may be entitled to a retirement in-some [illegible] any taxable part of your annuity benefits. For a detailed discussion of this see Publication 524, "Retirement Income Credit." This free publication is available by sending a postcard to your Internal Revenue office.

Tax computed by IRS. If your income on line 17, Form 1040, is $20,000 or less and consists only of wages or salaries and tips, dividends, interest, pensions, and annuities, and you choose the standard deduction instead of itemizing your deductions, you may elect to have the Internal Revenue Service figure your tax. To do this, complete lines 1 through 17, lines 19, 21, 23, 24, and 26 if it applies to you, and lines 32, 33 and 34.

If you are entitled to a retirement income credit, answer the question for columns A and B and fill in lines 2 and 5 of Schedule R, attach it to your Form 1040, and enter "RIC" on line 19, Form 1040. Your tax will be determined and you will either receive a refund for any overpayment or be notified of the amount of any tax due. Bills for tax due should be paid within 30 days after the date of mailing or by the due date of the return, whichever is later, to avoid interest or penalty charges.

A married person filing a separate return, who makes this election will have his tax computed on the basis of the percentage standard deduction rather than the low income allowance, unless he attaches to his return a declaration that the tax of his spouse was not determined with regard to the percentage standard deduction.

You may revoke this election by filing an amended return.

Disability Retirement

Disability annuity payments you receive on and after retirement date are never sick pay. This is true whether you retired early on disability or had already reached your retirement date when you retired on disability. These payments are reported [illegible] return and they are taxable beginning with or upon reaching your retirement date under either the 3-Year Rule or the General Rule.

Sick Pay

If you retired under the disability retirement provision of the Civil Service Retirement law, your annuity payments for any period before reaching your **retirement date** (defined below), are considered sick pay that is wholly or partially excludable from income for Federal income tax purposes.

You are not recovering the cost of your annuity while you are receiving sick pay. Thus, the cost of your annuity that is excluded from your income after reaching your retirement date is not reduced by the disability payments received before this date.

If you had already reached retirement date when your services terminated because of disability, the sick pay exclusion does not apply to you.

Retirement date. In determining your retirement date for sick pay purposes, count the years after the date you retired on disability as though you had not been disabled and had continued to work in creditable government service, up to the earliest date below that applies. Investigatory employees determine their retirement date, for sick pay purposes in the same manner.

If your services were terminated before July 18, 1966, you reach your retirement date at the earliest date applicable, as follows:

a) At age 60, with 30 years or more of service;

b) Upon completion of 30 years of service, if that date occurs after you reach age 60 but before you reach age 62; or

c) At age 62, or the date your services were terminated, whichever is later.

If your services were terminated after July 17, 1966, you reach your retirement date at the earliest date applicable, as follows:

a) At age 55, with 30 years or more of service;

b) Upon completion of 30 years of service, if that date occurs after you reach age 55 but before you reach age 60;

c) At age 60, with 20 years or more of service;

d) Upon completion of 20 years of service, if that date occurs after you reach age 60 but before you reach age 62; or

e) At age 62, or the date your services were terminated, whichever is later.

Sick pay exclusion. Generally, your sick pay up to $100 a week is excluded from your income. If you have not reached retirement date, as defined above, you determine your weekly rate of sick pay by multiplying your monthly disability annuity rate by 12 months and dividing the product by 52 weeks. Any amount over $100 a week is taxable as ordinary income.

Example. Your monthly disability annuity rate is $485, before any adjustment for health benefits. Your weekly rate of sick pay is $111.92 ($485 $\times$ 12 $\div$ 52 = $111.92). If you otherwise qualify, $100 a week is excludable sick pay and $11.92 a week is taxable as ordinary income.

To claim your sick pay exclusion, you report your disability annuity payments as wages on line 11, Form 1040. Then, the amount of your sick pay exclusion is included on line 46, Form 1040. You should attach a statement to your Form 1040 showing your computations. Form 2440, "Sick Pay Exclusion," may be used for this purpose.

Voluntary contributions to the Civil Service Retirement Fund and interest earned on them are not excludable as sick pay.

Other employment. You may continue to exclude your disability payments as sick pay even though you work for another employer or are self-employed, if you have not reached your retirement date. However, such employment may be considered in determining whether your retirement is actually due to a disability or for some other reason. Sick pay from another employer may also be excludable, even though you have reached your Civil Service retirement date.

If You Retired During the Past Year

A lump-sum payment for accrued annual leave received upon retirement is treated as a salary payment. It is not excludable sick pay and is taxed as ordinary income in the tax year the payment is received.

Your gross salary is also taxed as ordinary income in the tax year payment is received.

First 30 days of absence. You may have been on sick leave drawing full pay, or you may have been receiving disability payments, for all or part of the first 30 calendar days you were away from work.

The following is important, therefore, if you recently retired for disability and are filing your first income tax return as a disabled retiree who has not reached your retirement date.

If your weekly rate of sick pay is more than 75 percent of your regular pay, all of your sick pay for the first 30 calendar days of your absence is taxable. Thereafter, your sick pay is excluded up to $100 a week, until you reach your retirement date. If your absence during this period, because of injury or sickness, is charged to sick or annual leave, this rule applies since your weekly rate of sick pay is 100 percent of your regular pay. However, in almost all cases, your disability benefits from the retirement fund will be 75 percent or less of your regular pay.

If your weekly rate of sick pay is 75 percent or less of your regular pay, and you are hospitalized at any time for at least one day during your absence, your sick pay is excluded up to $75 a week for the first 30 calendar days. If you are not hospitalized, the same treatment applies for those 30 days except that the pay for the first seven days is taxable. After this 30-day period, your sick pay is excludable up to $100 a week.

Your regular pay is your average weekly salary for the four weeks immediately preceding the pay period in which your absence begins. If you were paid the same amount biweekly, your regular pay is one-half of your biweekly pay. For example, if you were paid $200 each biweekly period for at least two periods preceding the pay period in which your absence began, your regular pay would be $100.

Your weekly rate of sick pay is determined by multiplying your monthly disability payment by 12 and dividing the produce by 52. As to the amounts received for absence (because of your injury or sickness) charged to sick or annual leave, your weekly rate of sick pay is the same as "Your regular pay," as defined above.

Example. On Monday, March 1, 1972, you went on sick leave because of illness. Because of the nature of your illness, you retired on disability, effective May 1, 1972. Until that effective date, you received your regular salàry because of your accrued sick leave. You will not reach your **retirement date** until 1982, so you are now concerned only with the exclusion from gross income of the amounts received in 1972 since you first became absent from work. Before your disability retirement, your work week was five days and your gross salary every two weeks was $260. In 1972, you received seven monthly disability payments of $185, for a total of $1,295. You were hospitalized for two weeks during your absence.

Because you were on sick leave during the first 30 calendar days of your absence and, therefore, received your regular salary, your weekly rate of sick pay exceeded 75 percent of your regular pay of $130 ($260 ÷ 2). Thus, the amounts received for the first 30 calendar days of your absence are fully taxable. It is immaterial that you were hospitalized.

From April 1 through April 30, 1972, you can exclude your sick pay at the maximum weekly rate of $100. Your normal work week was five days, so your daily exclusion is $20 ($100 ÷ 5).

This is multiplied by 20 (the number of workdays

in April) to give you the amount excludable for that month, or \$400 (\$20 × 20).

Since the sick pay (your disability payments) for the period from May 1 through December 31, 1972, was at a weekly rate of less than \$100 [(\$185 × 12) ÷ 52 = \$42.69], the total of the disability payments (\$1,295) is excludable from income. Thus, your total sick pay exclusion for 1972 (assuming you had no earlier period of qualifying absence) is \$1,695 (\$400 + \$1,295).

Additional Information

If you retired before 1954, when the tax treatment for annuity payments was quite different, you have probably recovered your cost and the benefits you now receive are fully taxable.

If you are one of the relatively few retirees who made voluntary contributions to the retirement fund, you must report the portion of your annuity resulting from the voluntary contributions as a separate annuity, taxable under the General Rule. If you have made voluntary contributions, the Form W-2P, "Statement for Recipients of Annuities, Pensions or Retirement Pay," that you receive each year will state the portion of your monthly payments attributable to your voluntary contributions. The General Rule is discussed in Publication 575, "Tax Information on Pensions and Annuities," mentioned earlier.

Community property laws. If your annuity is based in whole or in part on Civil Service employment while married and domiciled in a state that treated your earnings as community property, the state community property laws apply to annuities payable under the Civil Service Retirement Act. Therefore, the benefit payments are subject to state community property laws determining the amount of the payments to be included in the gross income of a retired employee and his spouse, respectively.

Generally, under community property law, a Civil Service annuity must be allocated between separate and community income based on an allocation between services performed and contributions made while domiciled and working in community and non-community property states. This allocation of retirement income determines the computation of retirement income credits.

For a fuller discussion of community property see Publication 555, "Community Property and the Federal Income Tax," available free by sending a postcard to your Internal Revenue office.

For a more detailed discussion of Civil Service retirement benefits, Publication 721, "Comprehensive Tax Guide to U.S. Civil Service Retirement Benefits," may be obtained for 70¢ from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

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